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IN THE

Supreme Court of the United States

October Term, 1941.

314 U.S. 68

No. 656.

NORMAN JOHNSON, Suing on Behalf of Himself and All Other Stockholders in THE CURTIS PUBLISHING COMPANY Similarly Situated Who, Being Interested in the Subject Matter of the Complaint, Shall Become Parties Hereto,

Petitioner,

against

WALTER D. FULLER, MARY L. C. BOK, FRED A. HEALY, CARY W. BOK, BENJAMIN ALLEN, PHILIP S. COLLINS, BRUCE GOULD, PHILIP S. ROSE, WESLEY W. STOUT, LEWIS W. TRAYSER, JOHN B. WILLIAMS, and THE CURTIS PUBLISHING COMPANY,

Respondents.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit, and Brief in Support Thereof.

ARTHUR GARFIELD HAYS,
120 Broadway, New York City,
Solicitor for Petitioner.

JOHN SCHULMAN,
SEYMOUR M. HEILBRON,
ALAN S. HAYS,
Of Counsel.

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IN THE

Supreme Court of the United States.

October Term, 1941.

NORMAN JOHNSON, SUING ON BEHALF OF HIMSELF AND ALL OTHER STOCKHOLDERS IN THE CURTIS PUBLISHING COMPANY SIMILARLY SITUATED WHO, BEING INTERESTED IN THE SUBJECT MATTER OF THE COMPLAINT, SHALL BECOME PARTIES HERETO,

Petitioner,

—against—

WALTER D. FULLER, MARY L. C. BOK, FRED A. HEALY, CARY W. BOK, BENJAMIN ALLEN, PHILIP S. COLLINS, BRUCE GOULD, PHILIP S. ROSE, WESLEY W. STOUT, LEWIS W. TRAYSER, JOHN B. WILLIAMS, AND THE CURTIS PUBLISHING COMPANY,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, NORMAN JOHNSON, respectfully represents:

SUMMARY STATEMENT OF THE MATTER INVOLVED.

This case challenges the legality, on both constitutional and equitable grounds, of a "Plan of Reorganization and Recapitalization" of the defendant, The Curtis Publishing Company (hereinafter called the "Company"). The plan was devised at the instance of common stockholders in con-

trol of the Company's management for the primary purpose of evading payment of dividend arrearages on the preferred stock and cutting down the preferences of the preferred stock in other important respects as shown below (35).* It purported to be effected under Article VIII, Section 2582-801 of the Business Corporation Law of the Commonwealth of Pennsylvania where the Company was incorporated and domiciled. The statute is set forth in the appendix to the brief annexed hereto.

Petitioner is an owner of the Company's preferred stock (19) and brought a representative action to have the plan of reorganization declared invalid; to enjoin payment of principal and interest on the Company's debenture bonds and of dividends on its prior preferred stock until payment of the accumulations on his shares; or, alternatively if the Court held the plan otherwise valid, to require the Company's directors to pay to the Company the amount which the Company should have received but did not receive upon the issuance of new securities under the plan (3-18).

On April 30, 1940, the Company's capitalization consisted of 722,420 shares of $7 cumulative preferred and 1,733,041 shares of common stock exclusive of shares held by the Company (31). There was no funded debt (41; 20). There were accumulated unpaid dividends of $19.37½ per share on the preferred stock (35). On the above mentioned date, a proposal styled "Plan of Reorganization and Recapitalization" was submitted by the Board of Directors to the stockholders, under which:

(A) Consenting preferred stockholders might exchange each share of preferred (including accrued divi-

* Numbers refer to page numbers of Appellant's Appendix unless otherwise stated.

dends) for one newly created $10 3% debenture, one share of newly created *prior* preferred stock having a dividend rate of $3 cumulative plus $1 if earned, and 2½ shares of newly created common stock.

(B) The Company's stated capital would be reduced by $7,224,200 which sum would be transferred to surplus against which the new debenture bonds would be charged when issued (32).

(C) Non-consenting preferred stockholders might continue to hold their preferred shares, the values behind which, however, would be vitiated (1) by the creation of the senior preferences attached to the new debentures and prior preferred stock above mentioned; (2) by the reduction of $7,224,200 in stated capital; and (3) by the distribution of surplus at the rate of $10 per share exclusively to the consenting preferred stockholders.

(D) Common stockholders holding shares of no par value would receive new common shares of no par value, share for share.

(30-43)

At the time the plan was promulgated, the preferred stockholders held a liquidation preference at the rate of $119.37½ per share, consisting of $100 (41) plus the accrued dividends. As against this preferential right, the Company's net assets behind each share of preferred stock were only $52.80 (20). Immediately after the plan was consummated and by virtue of its operation the equity of the dissenting preferred stock which remained outstanding was wiped out in toto. The equity in *all* of the Company's net assets was diverted to the preferred stockholders who con-

sented to the plan. These consenting stockholders, to the exclusion of the dissenters, not only received the above-mentioned distribution of $10 per share in the form of debentures which reduced the surplus by approximately $6,700,000 but the entire balance of the Company's net assets became applicable to their newly issued prior preferred stock on which the liquidation preference was $65 per share (33).

The preferred stockholders were faced with these alternatives; if they accepted the exchange specified in the plan, they would be required to surrender shares entitled to $100 on liquidation, $120 on redemption and a dividend rate of $7 (26-29). They would receive in place thereof a prior preferred stock entitled to $65 on liquidation, $75 on redemption and a maximum dividend rate of $4 (33); plus the debenture and common stock above described. Those accepting the plan would likewise be required to surrender their claim for accumulated dividends of $19.37½ per share. The plan expressed confidence that regular dividends on the prior preferred stock would be paid uninterruptedly (35). As against this, the plan held out no hope for dividend payments to the dissenting stockholders.* The dissenting stockholders could retain their shares together with the claim for accumulations but they would be subordinated and deprived irrevocably of their equity since, as above stated, the assets were insufficient in amount to cover the preferences of the newly created senior securities.

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* This prognostication proved justified. Shortly after the new stock was delivered to the public, a regular dividend of 75¢ per share on the prior preferred stock was declared payable January 1, 1941 (25) but no dividend was declared on the unexchanged preferred stock even though this was the "regular" date for the payment of dividends thereon.

The right of the dissenters to accumulated dividends, though not "waived", would be rendered virtually meaningless, there having been a diversion of the funds with which to pay them and there being no reasonable prospect currently or in the foreseeable future of earnings sufficient to pay the accumulations as well as the sinking fund and interest requirements on the debentures and the dividend requirements on the prior preferred stock.

The common stockholders on the other hand were faced with no dilemma. Although there was a surplus of $20,000,000, the Company had fixed its stated capital at so low an amount that the capital together with the "surplus" was only sufficient to cover the preferred stock by less than half (41). In consequence, the common stockholders had no equity. Their position was such that according to the Company's treasurer there was no hope of an equity ever being established for them (85, 72) under the Company's capitalization prior to the plan. Their proportionate interest in the total common stock was diminished by half because of the new common stock issued to assenting preferred stockholders under the plan, but the interest which they relinquished was one-half of zero (85). In return for giving up one-half of a non-existent equity their position was improved substantially, first by reason of the waiver of accumulated dividends by the assenting preferred stockholders, and second by reason of the diminution of preferential rights in respect of the preferred stockholders who accepted the plan.

The plan was consummated over the protest of petitioner and other stockholders. The holders of more than 60,000 shares of preferred stock refused to make the exchange of securities.

Without the affirmative vote of the defendant Company's officers, directors and associates,* the plan would not have received the percentage of votes required for approval (37, 38; 21, 22). These persons (37, 38) held some preferred, but were interested chiefly in the common stock (49.3% of the outstanding shares) on which no dividends could be paid because of arrears on the preferred. Out of 12,131 holders of preferred stock, 5,617 of those who held preferred stock and who did not also hold common stock either voted against the plan or did not register their votes at all (22).

The record shows that the chief beneficiaries of the plan were the Company's officers, directors and associates, and the other common stockholders. According to a defendants' witness, a purpose of the plan was to divert earnings from the preferred to the common so that the common-stock-management would not try "to make money in other ways" to the disadvantage of those holding preferred shares (86). The Company itself faced no emergency. Witnesses for the defendants testified that there was no financial stringency facing the Company (91) and that on the contrary the Company's credit was superlatively good (87).

The evidence shows also that during the period 1933-39 while dividends were accumulating on the preferred stock, the Company spent $5,938,137 for purchases of its own common and preferred stock (66-78). According to the Company's treasurer, the money was not used to pay dividends because that would have been "milking the Company" (83). The amount spent for stock purchases, to-

* "Associates" as defined by Rule X-14A-8 of the Securities and Exchange Commission under the Securities Exchange Act of 1934.

gether with the $6,700,000 which was charged against the issuance of debentures as above stated, would have been sufficient to pay practically the entire accumulations on the preferred shares (35).

The District Court rendered judgment dismissing the complaint (Opinion printed at 118).

The plaintiff having duly appealed to the United States Circuit Court of Appeals for the Third Circuit, that Court, on June 27, 1941, affirmed the judgment. The opinion of the Honorable John Biggs, Jr., Circuit Judge, is printed in the record submitted herewith.

STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked under the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (United States Code, Title 28, Section 347 (a)).

QUESTIONS PRESENTED.

The following are the questions presented by petitioner:

I.

A. May a corporation organized under the laws of Pennsylvania amend its articles of incorporation so as to

(a) Create debenture bonds and prior preferred stock and, without obtaining any cash or property or any benefit to the corporate entity, issue these newly created securities to assenting preferred stockholders upon the condition that such stockholders waive their claim to accumulated dividends and accept diminished preferences, while

(b) Non-assenting preferred stockholders who retain their shares are subordinated to the new debentures and prior preferred stock, and

(c) The assets of the company which, before the amendment were insufficient to cover the preferential claims of the preferred stockholders are shifted in their entirety, against the will of such stockholders, to support the preferential claims of the debenture holders and prior preferred stockholders, thus wiping out the equity of the non-assenting preferred stockholders, while at the same time

(d) The common stockholders, who have no equity, receive new common stock, share for share?

B. If the Business Corporation Law of Pennsylvania authorizes such an amendment, does not the Law in that respect violate Article I, Section 10 and the Fourteenth Amendment of the Constitution of the United States?

II.

A. Is not the decision in this case refusing to enjoin payments on the new prior preferred stock and debentures inconsistent with the decision of the Supreme Court of the Commonwealth of Pennsylvania in *West Chester & Philadelphia R. R. Co. v. Jackson*, 77 Pa. St. Rep. 321, wherein it was held that a preferred stockholder who refused to exchange his shares for new prior preferred stock in a "voluntary" recapitalization was entitled to receive all of the accumulated dividends on his stock before the corporation could pay any dividends on the new prior preferred stock; and did not the Circuit Court of Appeals err in failing to apply the principle of that case herein?

B. Did not the Circuit Court of Appeals err in refusing to hold that the payment of dividends, interest and sinking fund requirements on the prior preferred stock and

debentures while accumulated dividends remain unpaid on the unexchanged preferred stock constitutes an unlawful invasion of petitioner's vested rights guaranteed by the Constitution of the United States?

III.

A. May a corporation organized under the laws of Pennsylvania amend its charter so as to distribute a substantial portion of its surplus through the issuance of debentures where such distribution is restricted to those preferred stockholders who waive their vested rights to accumulated dividends and is denied to other preferred stockholders of the same class who refuse to waive their vested rights?

B. If the Business Corporation Law of Pennsylvania authorizes a charter amendment having the effect above described, does not the Law in that respect violate Article I, Section 10 and the Fourteenth Amendment of the Constitution of the United States?

IV.

A. Were not the assets of the corporation in this case employed for a purpose not germane to the business of the corporation inasmuch as they were shifted under a plan for the purpose of inducing preferred stockholders to give up rights so that ultimately the common stockholders would benefit, and may a State properly authorize a corporate charter to be amended so as to permit such use to be made of the corporate assets?

B. If the Business Corporation Law of Pennsylvania authorizes such use of corporate assets, does not the Law in that respect violate Article I, Section 10 and the Fourteenth Amendment of the Constitution of the United States?

V.

Is not the decision in this case inconsistent with the decisions of this Court in *Southern Pacific Co. v. Bogert*, 250 U. S. 483, and *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765, cert. denied, 229 U. S. 615, wherein it was held that dominant stockholders of a corporation occupy a fiduciary relation to minority stockholders and may not use their power to benefit themselves at the expense of the minority; and did not the Circuit Court of Appeals err in failing to apply the principle of such cases?

VI.

A. Prior to the reorganization herein, did not the preferred stockholders enjoy a vested right in the defendant company's net assets to the extent that, except for distribution on dissolution or for the payment of dividends the Company was required to keep such assets intact (subject only to diminution by losses in business operations) to safeguard the preferential rights of the preferred stock; and did not the charter amendment adopted under the plan of reorganization unlawfully destroy such vested right of those preferred stockholders who refused to waive their vested right to accumulated dividends, since it deprived them of all of their entire equity in the assets originally behind their shares without their consent and against their objection?

B. If the Business Corporation Law of Pennsylvania authorizes a charter amendment having the effect above described, does not the Law in that respect violate Article I, Section 10 and the Fourteenth Amendment of the Constitution of the United States?

VII.

A. Did not the Circuit Court of Appeals err in failing to hold that the reorganization of the corporate defendant

was invalid inasmuch as the reorganization gave substantial recognition to the common stockholders who had no equity in the corporate assets?

B. Is not the decision herein inconsistent

(1) with the principle of the decision of the Supreme Court of the Commonwealth of Pennsylvania in *Petry v. Harwood Electric Co.*, 280 Pa. St. Rep. 142, 124 Atl. 302, wherein the Court expressly recognized that in a case of merger, common stockholders would not be entitled to receive any new securities unless there were sufficient assets to pay preferred stockholders in full; and

(2) with the principle of the line of decisions of this Court commencing with *Northern Pacific Co. v. Boyd*, 228 U. S. 482; and did not the Circuit Court of Appeals err in failing to apply the principles of such cases?

REASONS FOR GRANTING THE WRIT.

The writ should be granted because:

(a) This Court has never passed upon the principal question here involved, namely, to what extent a plan of recapitalization may be imposed upon non-consenting stockholders. This question is one of wide importance.

(b) Substantial constitutional questions are involved. *Article I, Section 10* and the *Fourteenth Amendment* of the Constitution of the United States.

(c) On other important aspects of the case, the decision of the Circuit Court appears to be in conflict with decisions of this Court and the Supreme Court of Pennsylvania.

Southern Pacific Co. v. Bogert, 250 U. S. 483;

Northern Pacific Ry. Co. v. Boyd, 228 U. S. 482;
West Chester & Philadelphia R. R. Co. v. Jackson, Admx of Gray, 77 Pa. St. Rep. 321;
Petry v. Harwood Electric Co., 280 Pa. St. Rep. 142, 124 Atl. 302.

"Recapitalization" is rapidly becoming a mode for wiping out dividends which have accrued to preferred stockholders and for diminishing preferences on liquidation and redemption.

During the days of the depression many companies were unable to pay preferred stock dividends out of current earnings. When, however, business improved so as to show larger earnings, the managements of these companies have sought means to get rid of the obligation to preferred stockholders in order to enable dividends to be paid on the common stock in which the management ordinarily is more interested. A simple scheme, which has arisen to such proportions as to become a public scandal, is to issue a new prior preferred stock (and perhaps debentures as in this case) with the intimation that this will pay immediate dividends and that those who hold their old preferred stock will have their claims both to dividends and on liquidation deferred indefinitely. The Curtis Publishing Company at all times had a surplus twice the amount of accumulated preferred dividends. It was in no financial difficulty. The management, however, regarded the payment of accrued dividends as a "milking" of the company and thus proposed a plan to avoid this situation.

This Court has never considered the legality or fairness of these "voluntary" reorganization plans, prepared and forced through by a common stock acknowledgment.

Insofar as they impair the quasi-creditor right of the preferred shareholders to be paid due and accrued divi-

dends, they present a Federal question arising under the Constitution. In view of the widespread use of this type of plan and millions of dollars in preferred dividends that annually are being taken away from innocent and largely helpless small investors, the subject would seem of such importance to entitle it to review and examination by this Court.

The right of preferred shareholders to be paid dividends that have accrued under the cumulative provision of the stock has been referred to as a vested property right or interest in many of the decisions. If it be such a property right, it is entitled to some reasonable degree of protection and this it is not afforded under these plans.

This Court, in other decisions, has laid down certain basic principles governing the obligations of majority stock managements to the powerless minority. The treatment accorded the small stockholders in these plans of recapitalization runs counter to the holdings in these decisions and to every concept of fair play.

Again, the law on the subject is in a most unsatisfactory state, with conflicting decisions on every side and the rights of investors left to the unguided judgment of each particular judge.

In *Davison v. Parke, Austin & Lipscomb, Inc.*, 285 N. Y. 500 (May 29, 1941), the Court of Appeals of the State of New York held that dissenting preferred stockholders were entitled to receive accrued dividends before any dividends could be paid on certain new preferred stock issued under the recapitalization plan involved therein. The Court said at page 506:

> "The issue thus presented is today one of great importance. It is common knowledge that during the

past few years many corporations have been unable to pay dividends either upon common stock or preferred stock and that large amounts of unpaid cumulative dividends, constituting as they do a first charge upon future profits, have a tendency to discourage new investment. Balanced against the desire to encourage investment, however, is the sanctity of the rights of contract. The individual preferred stock investor has bargained for certainty in his return, and may not be deprived of his bargain without express statutory authority. Solution of the problem is further complicated by the fact that any device the use of which is desirable in proper cases for the elimination of burdensome preferential rights of preferred stockholders may be used in other cases, without regard to corporate needs and for the sole benefit of common stockholders."

The defendants in this case admit that the plan was effected to benefit the common stockholders.

It is believed that this case is regarded already as a leading and chief authority in the field. The fundamental question today has become one of substantial importance to investors throughout the nation. Litigation on the question has arisen in various jurisdictions, but this Court has never passed upon the issue which by and large is fundamental in a large number of the past and current plans of reorganization and recapitalization. In view of its bearing upon investors generally, the question is one which should be passed upon by this Court so as to provide future guidance.

WHEREFORE, petitioner prays that a writ of certiorari may issue out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Third Circuit, commanding the said Court to certify and send to this Court for review and determination as pro-

vided by law this cause and a complete transcript of the record and of all proceedings had herein; and that the order of the United States Circuit Court of Appeals affirming the judgment in this cause may be reversed and that petitioner may have such other and further relief in the premises as this Court may deem appropriate.

Dated, New York, September 25, 1941.

NORMAN JOHNSON,
Petitioner.

ARTHUR GARFIELD HAYS,
Solicitor for Petitioner.

VERIFICATION FOR THE PETITION.

UNITED STATES OF AMERICA,
SOUTHERN DISTRICT OF NEW YORK.

STATE OF NEW YORK,
COUNTY OF NEW YORK, } *ss.:*

NORMAN JOHNSON, being duly sworn, says:

I am the petitioner herein.

I have read the foregoing petition by me subscribed, and know the contents thereof. The facts therein stated are true to the best of my knowledge, information and belief.

NORMAN JOHNSON.

Sworn to before me this 25th day of September, 1941.

FREDERICK GRIFFIN,
Notary Public, New York County.
Commission expires March 30, 1942.

STATE OF NEW YORK,
COUNTY OF NEW YORK, } *ss.:*

I hereby certify that I have examined the foregoing petition for a writ of certiorari and that in my opinion it is well founded, and the cause is one in which the petition should be granted.

ARTHUR GARFIELD HAYS.

Sworn to before me this 25th day of September, 1941.

FREDERICK GRIFFIN,
Notary Public, New York County.
Commission expires March 30, 1942.